FEDERAL RESERVE BANK

OF DALLAS

Dallas, Texas, March 6, 1965

GUIDELINES FOR COMMERCIAL BANKS UNDER THE VOLUNTARY FOREIGN CREDIT RESTRAINT PROGRAM

To All Banks in the
Eleventh Federal Reserve District:

There are transmitted herewith guidelines for the Voluntary Foreign Credit Restraint Program that should be of assistance to commercial banks in dealing with particular situations under the program, and in meeting the suggested goal for limiting foreign credits.

Additional copies of these guidelines may be obtained from this Bank or appropriate branch. Your cooperation in this important program will be appreciated.

Yours very truly,

Watrous H. Irons
President

GUIDELINES FOR COMMERCIAL BANKS UNDER THE VOLUNTARY FOREIGN CREDIT RESTRAINT PROGRAM

The following guidelines have been designed by the Board of Governors of the Federal Reserve System for use in implementing President Johnson's program for the voluntary curtailment of foreign credit by banks. They will be in effect until modified or supplemented. However, they may be changed from time to time in the light of new circumstances and in the light of the experience gained as the program goes forward. The guidelines should be helpful to individual banks as they play their own particular part in the achievement of the President's over-all balance of payments program, and each bank should feel free at any time to discuss its problems with the Federal Reserve Bank of its district.

It is clear that banks, in undertaking a voluntary role in the program, are being called upon to make sacrifices. In restraining the growth of their loans to foreigners, they will be foregoing some of the gains that would otherwise have accrued to them. But, if a voluntary program is to be effective, decisions on future specific loan transactions must be made primarily with an eye to the national interest rather than profits. The achievement of the President's goal will be in the long-term interest not only of the nation, but also of the individual institutions which are now being called upon to forego immediate advantage or gain.

(1) ESTABLISHING A TARGET BASE FOR AN INDIVIDUAL BANK

The objective of the program is that outstanding bank credit to nonresidents of the United States not rise above the amount outstanding at the end of 1964 by more than 5 per cent, subject to the conditions set forth in guideline number (3).

The following steps are involved in calculating the base, and the amount of credit outstanding on any particular date, for an individual bank:

1. Take outstanding claims of U. S. banking offices on foreigners as of December 31, 1964, as required to be reported on Treasury Department foreign exchange forms B-2 and B-3. Contingent accounts such as unused balances of letters of credit and commitments to lend, are excluded from the base. (For further information reference is made to the instructions printed on forms B-2 and B-3.)

2. Subtract from this amount any claims for account of customers included on the forms, as well as any participations in individual loans arranged by the Export-Import Bank or made with Export-Import Bank guarantees.

3. Add any claims not reportable on forms B-2 and B-3, such as long-term foreign securities and permanent capital invested in foreign branches and subsidiaries.

4. Compensating balances, or any other claim on the lending bank of the debtor or of any other person by arrangement or understanding with the debtor, should not be deducted from loans or other claims on foreigners for purposes of determining the base.

5. It is expected that a simplified form for making the above calculation, and for making monthly reports on foreign credits, will be furnished to the banks within a short time.

Banks which are exempted from reporting on the Treasury forms because their foreign credits are below the minimum reporting requirement are nevertheless included in the program.

(2) PARTICIPATIONS IN EXPORT-IMPORT BANK LOANS AND LOANS GUARANTEED BY THE EXPORT-IMPORT BANK

Participations in individual export loans arranged by the Export-Import Bank, loans with Export-Import Bank guarantees or insurance, and holdings of "Export-Import Portfolio Fund" participations are excluded from the 5 per cent target.

The role of the Export-Import Bank within the framework of the President's program will be coordinated by the National Advisory Council for International Monetary and Financial Problems.

(3) BANKS IN EXCESS OF 5 PER CENT TARGET

It is clearly recognized that some banks may currently be above the 5 per cent target because of loans made prior to February 11, 1965, or may subsequently be brought above the target as a result of (A) binding commitments entered into before February 11, or (B) the extension of bona fide export credits, or (C) the extension of credits at the specific request of an agency of the U. S. Government. A bank in such circumstances would not be considered to be acting in a manner inconsistent with the program. However, it should reduce its claims on foreigners to 105 per cent of the base as quickly as possible. Even in the most extreme case, this reduction should be accomplished within the next twelve months.

Such a bank will be invited periodically to discuss with the Federal Reserve Bank of its district the steps it has taken and proposes to take to bring about the reduction of its claims on foreigners consistent with these guidelines.

Banks with bona fide commitments are clearly not being asked to refuse to honor such commitments, even if honoring them involves a temporary excess of lending above the target. However, banks would be expected to seize every opportunity to withdraw or reduce commitments, including credit lines, that are not of a firm nature, and to ensure that drawings under credit lines are kept to normal levels and usage. At time of renewal, all credit lines should be reviewed in light of their consistency with the voluntary foreign credit restraint program. Proposed extensions or renewals of existing bona fide commitments should be reviewed in the same manner.

(4) LOAN PRIORITIES

Within the 5 per cent guideline, absolute priority should be given to bona fide export credits. Credits that substitute for cash sales or for sales customarily financed out of nonbank or foreign funds are not entitled to priority.

With respect to nonexport credits, banks should give the highest priority to loans to less developed countries and should avoid restrictive policies that would place an undue burden on countries such as Canada and Japan, which are heavily dependent on U. S. financing, and on the United Kingdom, which is suffering from balance-of-payments difficulties.

Given the probability of some expansion of the end-of-1964 volume of loans for financing exports and the priorities established for the less developed countries, as well as the need to avoid restrictive practices with regard to Canada, Japan, and Britain, it is expected that nonexport credit to the other advanced countries will be cut back to the extent needed to achieve the goal of the President's program.

Without attempting to specify all types of loans that will need to be restricted, it is obvious that credits to developed countries that can be cut back with benefit to our balance of payments and with the least adverse side-effects include: credits to finance third-country trade; credits to finance local-currency expenditures outside the United States; credits to finance fixed or working capital needs; and all other nonexport credits to developed countries that do not suffer from balance-of-payments difficulties.

(5) BANK SALES OF FOREIGN ASSETS TO U. S. RESIDENTS

In general, banks should not expand their lending abroad by selling to U. S. residents (including U. S. banks) claims on foreigners existing as of the base date and replacing such assets with other loans to foreigners. Sales to U. S. residents of foreign securities owned on the base date, which would be free of the Interest Equalization Tax, or of loan participations, could assist an individual bank to stay within the 5 per cent target, but would clearly not benefit the U. S. payments position. Therefore, in the event of any such sales the bank's base should be reduced by an amount equivalent thereto.

(6) BANKS WITH NO FOREIGN LOANS OUTSTANDING ON DECEMBER 31, 1964

In general, banks with no previous foreign lending experience would be expected not to make foreign loans during 1965. However, bona fide export loans to foreigners may be made in reasonable amounts, provided this financing does not represent a shift from previous U. S. or foreign sources of financing. Banks making foreign loans for the first time should take precautions to ensure that their activities do not become a means through which credit is extended to foreign borrowers who have been denied credit by established lenders cooperating in the voluntary program.

(7) BANKS WHOSE PREVIOUS FOREIGN BUSINESS HAS CONSISTED ALMOST ENTIRELY OF EXPORT FINANCING

The few banks falling in this category would ordinarily be expected to keep within the 5 per cent ceiling. Since they would have no maturing nonexport loans to provide funds for additional export credits and would therefore need to rely upon nonrenewal of maturing export loans, reasonable amounts in excess of the target from time to time would not be considered in conflict with the program. But every effort should be made by such banks to keep their lending within the ceiling. They should take care to ensure that export loans do not represent a shift from previous U. S. or foreign sources of financing.

(8) TRUST DEPARTMENTS

Managing officers of Trust Departments should be made familiar with the voluntary restraint effort. They should bear the purpose of that program in mind in making any acquisitions of foreign obligations for trust accounts. For example, they should not exercise their authority under any trust account to acquire foreign obligations which, in the absence of the restraint program, would have been acquired by the bank for its own account. Pension funds, including those administered by banks, will be furnished separate guidelines, as part of the program to restrain foreign credits of nonbank financial institutions.

(9) FINANCIAL TRANSACTIONS FOR CUSTOMERS

While banks must, of course, follow instructions given to them by their customers, it is expected that, in buying foreign investments for customers, they will be guided by the principles inherent in the President's balance of payments program. They should not encourage customers to place liquid funds outside the United States. Banks should not place with customers foreign obligations which, in the absence of the restraint program, they would have acquired or held for their own account.

(10) FOREIGN BRANCHES

It is assumed, of course, that U. S. banks having branches, as well as subsidiaries and affiliates, in foreign countries will not utilize them to avoid the foreign credit restraint program for U. S. banks.

Foreign branches have independent sources of funds in the countries in which they are located and from third countries, in many cases through the attraction of Euro-dollar deposits. The balance of payments program is not designed to hamper the lending activities of the foreign branches insofar as the funds utilized are derived from foreign sources and do not add to the dollar outflow. Concern arises only in those cases where the resources are derived (directly or indirectly) from the United States.

Total claims of the Head Office on overseas branches, including permanent capital invested in, as well as balances due from branches, represent bank credit to nonresidents for purposes of the program.

(11) PROBLEMS OF EDGE ACT CORPORATIONS

Edge Act and Agreement Corporations are included in the voluntary credit restraint effort. The foreign loans and investments of such a corporation may be combined with those of the parent bank for the purposes of the program, or separate targets may be set for the parent bank and the subsidiary.

An Edge Act Corporation that has not yet undertaken any significant volume of loans and investments may take as a base, alone and not in combination with its parent, its paid-in capital and surplus, up to $2.5 million, even though an equivalent amount of foreign loans and investments had not yet been made as of December 31, 1964.

(12) U. S. BRANCHES AND AGENCIES OF FOREIGN BANKS

Branches and agencies of foreign banks located in the United States are requested to comply with the principles of the program of credit restraint applicable to domestic banks.

(13) SUBSTITUTION OF EXPORT CREDIT FOR CREDIT FOR OTHER PURPOSES

Banks should be on the alert to avoid granting credit to domestic customers if the result would be to aid the latter in making foreign loans or investments inconsistent with the program. Even export credit to foreigners, if it supplants credit previously obtained from foreign sources and thus frees the foreign funds for other uses, may be detrimental to the U. S. payments position.

This is obviously a difficult area and one in which there is considerable room for possibly damaging substitution of domestic for foreign financing, and for substitution of export credits to foreigners for other credits to foreigners. In general, success will depend on the ability of banks to identify loans that are inconsistent with the program and on the application of the Department of Commerce program with respect to foreign credit and investment by nonfinancial firms.

(14) MANAGEMENT OF A BANK'S LIQUID FUNDS

Banks that have placed their own funds abroad for short-term investment purposes, including U. S. dollar deposits outside the United States or the acquisition of non-U. S. money market paper, should refrain from increasing such deposits and investments and should, in a reasonable and orderly manner, seek to reduce them. Since such funds are ordinarily placed outside the United States solely to provide a slightly higher rate of return, they are strong candidates for reduction under the program.

This guideline applies equally to deposits and investments payable in foreign currencies and to those payable in U. S. dollars.

This guideline does not call for a reduction in necessary working balances held with foreign correspondents, although such balances are also considered claims on nonresidents for the purposes of the program.